

# CASNER & EDWARDS, LLP

303 Congress Street  
Boston, MA 02210

Richard C. Allen, Esq.  
allen@casneredwards.com

Telephone 617-426-5900  
Facsimile 617-426-8810  
www.casneredwards.com

## GOVERNANCE REVIEW REPORT ST. PAUL'S SCHOOL April 16, 2004

I have been asked by St. Paul's School, Concord, New Hampshire, to conduct a comprehensive review and assessment of the institutional governance structure, policies and practices of St. Paul's School and to provide a report, including any recommendations, to the Board of Trustees. My report, including conclusions and recommendations, is set forth below.

My perspective includes:

- Twelve years as Chief of the Division of Public Charities of the Massachusetts Attorney General's Office, in charge of the Attorney General's oversight of charitable organizations and charitable funds. As Public Charities Division Chief, I led the investigation and negotiation of several charity governance reform agreements, and served as President and Board Member of the National Association of State Charity Officials. During this time, the Division published *The Attorney General's Guide for Board Members of Charitable Organizations*, which was the model for similar guides issued by the Attorneys General in many states, and held numerous statewide training conferences for Board members of charitable organizations.
- My practice at Casner & Edwards, LLP, specializing in the representation of nonprofit organizations, in which I advise organizations with respect to fiduciary and governance responsibilities, charities law issues, tax exemption matters, corporate law questions, charitable trust topics, fundraising law issues, and governmental regulatory matters.

In the course of this review, I examined a variety of written materials, including many St. Paul's School documents and consultant reports relating to various aspects of the governance and operation of the School,<sup>1</sup> and numerous background publications,

---

<sup>1</sup> Examples of documents reviewed are listed in Attachment A.

standards, policies and model documents in the area of nonprofit organization governance. In addition to visiting St. Paul's School, I conducted interviews with several Trustees, members of the School Administration, and others.

From the outset, St. Paul's School pledged total cooperation with this review and complete access to any information that I needed, and such cooperation and access have been fully received. Further, with the School's permission, I invited all Trustees to contact me privately and in confidence with any recommendations or concerns regarding any aspect of the School's institutional governance that they would like me to know or consider, and a number of Trustees availed themselves of this opportunity.

### CONCLUSION

St. Paul's School is very well governed. The School's Board of Trustees is actively and effectively engaged in the governance of the organization and is appropriately independent of the institution's management. The Board is comprised of volunteers from throughout the United States and abroad who are highly accomplished individuals, who are devoted to the well-being and success of the School and its educational mission, and who take their fiduciary responsibilities as Trustees very seriously. The Board is scrupulous in the oversight of the organization's finances and in the avoidance of conflict of interest activities.

As with any organization as complex as a boarding school, there are refinements to the governance structure and processes of St. Paul's School that deserve consideration. Such refinements are identified in the analysis below (recommendations are marked in bold, and are summarized at the end). That I have, through this focused review conducted separately from the pressures and time demands of ongoing governance, identified refinements to be recommended or considered should not be interpreted as reflecting critically on the overall governance of St. Paul's School.

### ANALYSIS AND RECOMMENDATIONS

#### A. St. Paul's School Board of Trustees

St. Paul's School is governed by a Board of Trustees. At present, there are twenty-four Trustees, including the Rector who serves *ex officio*.<sup>2</sup> A President, Clerk, and Treasurer are elected each year by and from the Trustees.

All Trustees except the Rector are unpaid volunteers, and none of the outside Trustees is related to the Rector or other top members of the School's Administration. The outside Trustees are well regarded individuals from throughout the United States and abroad, many holding high level positions in business, the professions, and the nonprofit

---

<sup>2</sup> The St. Paul's School's Bylaws authorize a Board of fifteen to twenty-eight Trustees.

sector. Many Trustees are alumni of St. Paul's School with a strong passion for the School's well-being and the success of its educational mission.<sup>3</sup>

The St. Paul's Board is conscientious about examining the quality of its governance on an ongoing basis and making adjustments when appropriate or beneficial. Over the past several years, St. Paul's School has made frequent use of outside, independent expert consultants and advisors of high caliber to guide the Board in the exercise of its responsibilities.

**B. Board of Trustees active engagement in governance**

The St. Paul's School Board of Trustees is actively engaged in the governance of the School. The Board holds regular meetings in October, January/February, and April/May, each meeting covering as many as three days. Special meetings are convened as needed. An Executive Committee and several other Board committees are active between Board meetings, and the Board Chair serves in an active institutional oversight and planning role throughout the year.

Attendance at Board of Trustee meetings is strong, especially considering the geographic diversity of the Board's membership, with an average of 75% of the Trustees in attendance. Trustees who do not actively attend and participate are rotated off the Board. Minutes of Board meetings are maintained that are comprehensive, detailed and informative. Agendas and materials are sent to the Board members in advance of the meeting. Discussion is active and participatory, with decision making that is independent of and not dominated by management.

**Recommendation:** Under the St. Paul's School Bylaws as presently written, it appears that a majority vote of a quorum of seven Board members could be sufficient to amend the Bylaws. (Sections 6.2 and 7.1) Likewise, it appears that a majority vote of a quorum of seven could approve other significant corporate actions such as amendment of the charter, merger, change of location, sale of the assets, and dissolution of the corporation. A higher voting threshold for these significant corporate actions is typical, and I recommend that a higher threshold be added, such as requiring the vote of a majority of the Trustees then in office (this is the vote threshold in the St. Paul's School Bylaws for removal of a Trustee, for electing or removing the Rector, and for the sale of real estate).

**Recommendation:** Also, the reference to Section 1.6 of the Bylaws in Section 6.2 should be corrected to refer to Section 1.7.

---

<sup>3</sup> Under the Bylaws, the Trustees include the President of the Alumni Association of St. Paul's School and the President of the Parents Association of St. Paul's School.

C. Trustee and Officer terms, tenure, recruitment and election

1. Trustees

Under the St. Paul's School bylaws as presently written, Trustees are elected by the Board for four-year terms.<sup>4</sup> They may be removed, with or without cause, by a majority of the Trustees in office. There is a limit of three consecutive terms, not including service to fill an unexpired term, with a one-year ineligibility thereafter. Section 1.3.<sup>5</sup>

The St. Paul's Board reflects a healthy mix of continuity, experience, and institutional memory on the one hand, and new membership with fresh perspectives and talents on the other hand:

- of the 23 Trustees (not including the Rector), 15 Trustees have served for four years or less of current service, while 8 have served for more than four years;<sup>6</sup>
- only 4 Trustees have served for more than eight years of current service;
- the median length of current Trustee service is 4 years, and the average length of current service is 5.5 years.

Attachment B sets forth more details on the length of service of the current Trustees.

The Board's Nominating and Evaluating Committee actively recruits new Trustees who bring diverse backgrounds, talents and perspectives to the Board. The Trustee recruitment and selection process is carried out with a healthy mix of consultation with, but independence from, management.

Although the St. Paul's School Board has been experiencing healthy turnover in recent years, the question of whether the current Trustee term provisions are appropriate or should be revised is under consideration by the Trustees. There is no single answer to the question of an appropriate term-limit formula -- most nonprofit organizations have

---

<sup>4</sup> There are three exceptions, mainly not germane to the above discussion: (a) the Rector, who is a Trustee ex officio; (b) the President of the Alumni Association, who becomes a Trustee with a four year term by virtue of the Alumni Association presidency; and (c) the President of the Parents Association, who is a Trustee ex officio. Bylaws, Sections 1.4 and 4.1.

<sup>5</sup> One current Trustee is a "Life Trustee" under a former set of bylaws, with a term ending in 2006.

<sup>6</sup> One Trustee served previously for 4 years, with a 23-year hiatus before the current service, and another Trustee served previously for 8 years, with a 13-year hiatus before the current service. No other Trustee served as Trustee prior to their current service.



terms limits, but the exact parameters vary widely, and governance commentators articulate various approaches. The current St. Paul's School Bylaws reflect good governance practices by having fixed terms and a limit on consecutive service. Three four-year terms is toward the longer end of typical practice, although it is not out of line for complex institutions. The one-year hiatus is typical.

The Attorney General's governance consultant has recommended that the Bylaws be amended to provide that the President have the authority to suspend a Trustee pending a vote of the full Board. I do not agree with this recommendation. In my view, the current Bylaw provision, providing for removal by a majority of the Trustees, is sufficient, and I do not recommend placing Trustee suspension power in a single officer.

The Attorney General's governance consultant has recommended a maximum of three three-year terms, followed by a three-year hiatus. He has also recommended that such new limits be applied immediately and retroactively to the current Trustees, modified by a transitional rule.

**Recommendation:** The current term provisions in the St. Paul's School Bylaws do not violate any legal requirements, and given the large number of newer Trustees on this very engaged Board, there is no need for forced retirements or other drastic remedies. It is also important to keep in mind that term limits are not an end in themselves. Rather, they are a means to the goal of maintaining a healthy mix of fresh perspectives, approaches, and talents along with continuity, experience, commitment, institutional memory, and institutional stability.

I do recommend, however, that the Board engage in a focused discussion of whether the Trustee term provisions as presently stated in the Bylaws should remain as written or whether they should be adjusted downward. A change is not mandated, but regular Board-wide consideration of the appropriate balance here is recommended.

## 2. Officers

The President, Clerk and Treasurer are elected each year by and from the Trustees at the annual meeting. Under the Bylaws as presently written, these officers are exempted from the above-mentioned term limit. Section 2.2.<sup>7</sup>

The present President of the Board has served in this office for 7 ½ years (9 years of current Trustee service). The Clerk has served in office for 11 years (17 years of current Trustee service). The Treasurer has served in office for 13 ½ years (26 years of

---

<sup>7</sup> The Bylaws also authorize the Board to elect Assistant Treasurers and Assistant Clerks, who may but do not need to be Trustees. Sections 2.1 and 2.2. The Bylaws are unclear as to whether a Trustee who is elected as an Assistant Treasurer or Assistant Clerk is thereby exempted from the term limits that otherwise would be applicable to the Trustee. Section 2.2

current Trustee service). All three have performed ably and with dedication to the best interests of St. Paul's School.

The St. Paul's School Officers, the Nominating and Evaluating Committee, and the Board as a whole are examining the question of officer term limits and succession planning. All three current Officers have expressed an interest in future retirement from office as part of an orderly transition that maintains strong and effective Board leadership for St. Paul's School.

The Attorney General's governance consultant has recommended a six-year limit for officers, with immediate retroactive application subject to a transitional rule.

**Recommendation:** Here again, no legal requirements are violated by the officer term provisions of the St. Paul's School bylaws, and the healthy governance of St. Paul's School does not require drastic remedies such as immediate forced retirements of the present Officers. Nonprofit organization practice and governance commentators vary as to whether there should be a term limit on officer service and, if so, what the appropriate outside limit on officer service should be. Further, I understand that many independent schools do not place term limits on officer service, on the ground that continuity of top board leadership contributes to institutional stability.

Even though both governance practice and governance guidance vary as to officer term limits, I recommend, given the fundamental nature of this subject to the governance of an organization, that, in conjunction with the Trustee term limits discussion recommended above (Part C.1), the Board consider whether to articulate an outside term limit for service as an Officer of the corporation, weighing the benefits of new perspectives, approaches and talents with the benefits of experience, commitment, and institutional stability.

To be clear, the present recommendation, and the two relating to officer election that are discussed immediately below, pertain to formal governance structure and procedure and should not be interpreted as reflecting negatively on the performance of the current Officers who have fulfilled their responsibilities so conscientiously and ably for the benefit of St. Paul's School.

**Recommendation:** I further recommend that, as part of addressing this topic, the Nominating and Evaluating Committee and the Board as a whole continue to focus on succession planning with respect to the corporation's three top offices. One approach to consider for Presidential succession, used by many organizations, is to create an office of Vice-President, also elected by and from the Trustees, while probably leaving open the question of whether the Vice-President is in effect the President-Elect.

**Recommendation:** Also, I recommend that the Nominating and Evaluating Committee submit Officer nominations to the Trustees in advance of the pertinent

Trustees meeting, and that during the Officer election discussion and vote, the candidates absent themselves from the meeting.

#### D. Committees

##### 1. Current committee structure

Under the St. Paul's School Bylaws, there is an Executive Committee, and the President may appoint such other standing or special committees as in his discretion he deems necessary or advisable. Historically the St. Paul's Board has functioned between meetings through numerous ongoing committees.

For example, the ongoing committees during the 1998-1999 year were: (i) Executive Committee; (ii) Ad Hoc Committee on Governance; (iii) Audit Committee; (iv) Budget, Pension & Benefits Committee; (v) Fundraising Committee; (vi) Grounds and Buildings Committee; (vii) Health and Wellness Committee; (viii) Investment Committee; (ix) Nominating and Evaluating Committee; and (x) School Life Committee.

For 2003-2004, the committees are: (i) Executive Committee; (ii) Audit Committee; (iii) Budget, Pension & Benefits Committee; (iv) Compensation Committee; (v) Fundraising Committee; (vi) Grounds and Buildings Committee; (vii) Health and Wellness Committee; (viii) Memorials Committee; (ix) Investment Committee; (x) Nominating and Evaluating Committee; and (xi) School Life Committee.<sup>8</sup>

**Recommendation:** The Bylaws provide that the Executive Committee "shall have all the powers of the Board," with the exception of: (a) Trustee election and removal; (b) Rector election and removal; (c) sale of real estate; and (d) as may be specifically limited by the Board. (Section 3.1). This grant of authority is overbroad, although there is no indication that the Executive Committee has in fact exercised authority beyond that which is reasonable. Nonetheless, consistent with the recommendation in Part B, above, regarding the voting threshold for significant corporate actions, this Bylaws provision should be amended to specify that full Board action is required for significant corporate actions such as election and removal of Officers, amendment of the Bylaws, amendment of the charter, change of the corporation's name, change of location, merger, sale of the corporation's assets, and dissolution.

##### 2. The Bylaws and other committees

The Attorney General's governance consultant recommends that the Bylaws be amended to clarify: (a) that the Board have establishment and approval authority with respect to the formation, continuation and cessation of committees; and (b) that the

---

<sup>8</sup> The function of the former Ad Hoc Committee on Governance is today one of the functions of the Nominating and Evaluating Committee.

following shall be standing committees of the Board (and with the responsibilities of each of these committees set forth in the Bylaws): (i) an Investment Committee; (ii) a separate Finance Committee; (iii) a Nominating-Governance Committee; and (iv) an Audit Committee.

**Recommendation:** While the Board already functions with an active committee structure, including the four committees specified above (the present Nominating and Evaluating Committee includes Governance within its purview, and the Budget, Pension and Benefits Committee functions as a Finance Committee), it would reflect best practice to amend the Bylaws to embody these principles as suggested above. Some organizations combine the Finance Committee function and the Investment Committee function into one committee, but the St. Paul's School Board has historically utilized separate committees for these functions and it makes sense to continue this. Consideration has been given by the Board to updating the name of the Nominating and Evaluating Committee to reflect the scope of its responsibilities – something like “Committee on Trustees” would better reflect the committee’s mission. Likewise, a name change of the Budget, Pension and Benefits Committee to something like “Finance Committee” would be more reflective of the committee’s function.

### 3. Committee appointments

Among nonprofit organizations, practice varies as to committee appointment authority (as does governance commentary as to the optimum approach), with common practices ranging from election of committee chairs and/or committee members by the Board, to appointment of committee chairs and/or members by the Board Chair (sometimes with consultation with or approval by the Board or the Governance Committee).

As provided in the present St. Paul's School Bylaws, committee appointments are made by the President in consultation with the other Officers and are reported to the Board. The Attorney General's governance consultant recommends that the Bylaws be amended to require that the Board approve the composition of committees, with the Executive Committee having the authority to fill vacancies that occur between Board meetings.

**Recommendation:** While the composition and performance of the ongoing committees does not indicate a problem with the present committee appointment arrangement, it would be an appropriate clarification in the nature of checks and balances to amend the Bylaws to require Board approval of committee appointments, with Executive Committee approval required with respect to committee appointments that need to be made between Board meetings.

#### 4. Independence of committee members

It is a recognized principle of good governance that an organization's Audit Committee, Governance Committee, and Compensation Committee should be independent – that is, the Committee should be comprised solely of members who are not employed by the organization, who do not have a business or financial arrangement with the organization or the organization's executives, who do not receive payment from the organization for service on the committee, and whose family members are not employed by, nor have a business or financial arrangement with, the organization.

Historically, the Rector has served on all Board committees, while recusing himself from consideration of matters affecting his personal interest, and St. Paul's School staff, while not voting members of Board committees, have provided assistance to the committees. As for the other Trustees, St. Paul's School has a conflict of interest policy that applies to Trustees in all facets of their Trustee role, including service on committees. Disclosures are signed annually, and these disclosures indicate that for most of the Trustees, there are no related party matters between St. Paul's School and the Trustees or their families or businesses (the rare exceptions are of a de minimis nature.).

**Recommendation:** The Audit Committee, Governance Committee, and Compensation Committee should be comprised solely of members who are independent as defined above. The Rector should not serve as a voting member of these committees, and the practice of staff not serving as voting members should continue (although the Rector and staff should continue to attend committee meetings and provide staff support, subject to recusal when the committee is considering matters affecting the individual's personal interests).

In addition, the Attorney General's governance consultant recommends that these independence concepts be applied to the Finance Committee and Investment Committee as well. The necessity of this is less evident for these committees, assuming that a committee member recuses himself or herself if the committee considers a matter affecting the individual's personal interests. Whether to apply these concepts to these two committees should remain within the discretion of the Board.

#### 5. Budget, Pension and Benefits Committee

Among other responsibilities, the Budget, Pension and Benefits Committee prepares and recommends a budget for the School to the Board of Trustees, recommends a five-year financial plan to the Board, and establishes the endowment spending policy in conjunction with the Board. As discussed above (Part D.2), a change of name to something like "Finance Committee" would better reflect the committee's mission.

The Attorney General's governance consultant recommends that the Treasurer may not be the Chair of this committee, although he or she may serve on the committee.

I do not agree that the Treasurer should be prohibited from serving as Chair of the Finance Committee. While in recent years the St. Paul's School Treasurer has served neither as the Chair nor as a member of this committee, I do not believe that there is reason to prevent such service. In fact, it is not uncommon for the Treasurer to fulfill this role in nonprofit organizations, a role that is described favorably by governance commentators.

#### 6. Investment Committee

The St. Paul's School Investment Committee, in consultation with the School's staff, establishes the organization's investment policy, selects investment managers, and reviews investment manager performance. (The role and authority of the Treasurer is discussed at Part E.1, below.)

The Attorney General's governance consultant recommends for this committee as well that the Treasurer may not be the Chair of the committee, although he or she may serve on the committee. Here again, I do not agree that the Treasurer should be prohibited from serving as Chair of the Investment Committee. In fact, the Treasurer is often the Chair of the Investment Committee in nonprofit organizations, a role that is logical from an institutional point of view and that is described favorably by governance commentators.

#### 7. Audit Committee

The St. Paul's School Audit Committee selects the auditor, reviews auditor fees, approves all work arrangements with the School by the auditor firm, reviews all reports from the auditor, meets with the auditor (including meeting without the presence of the staff) to review the auditor's findings, and reports to the Executive Committee and the full Board.

**Recommendation:** Historically, the Treasurer does not serve on the St. Paul's School Audit Committee. This is an important good governance practice and should be memorialized in the bylaw amendment (discussed at Part D.2, above) institutionalizing the Audit Committee in the Bylaws.

The Attorney General's governance consultant recommends that at least one member of the Audit Committee shall be a financial expert in the field of not-for-profit education.

**Recommendation:** Although a not-for-profit education financial expertise component of the Audit Committee is not a legal requirement, such expertise on the Audit Committee is an ideal that should be sought. The Nominating and Evaluating Committee should include this in the desired criteria for the recruitment of new Trustees,



with a goal of including at least one Trustee with this expertise on the Audit Committee. This goal, however, should be aspirational and not a requirement.

#### 8. Nominating and Evaluating Committee

Among other responsibilities, the Nominating and Evaluating Committee is responsible for Trustee recruitment, Trustee orientation and training, and evaluation of the governance practices and performance of the Board, of the committees, and of the individual Trustees. As discussed above (Part D.2), a change of name to something like "Committee on Trustees" would better reflect the committee's mission. More on the role and activities of this committee is discussed at Part G, below.

#### 9. Committee reports to Board

Some but not all of the St. Paul's School committees have been maintaining a written record of their work and reporting to the Board in writing.

**Recommendation:** All committees, including the Executive Committee (as required by Section 3.1 of the Bylaws), should maintain a written record of their work and report in writing to the full Board in advance of each Board meeting. Formal minutes are not required (unless required for another reason, such as compliance with the requirements of a funding source), but care should be taken to provide enough detail to inform the Board adequately as to the activities of the committee, and to fulfill any applicable requirements such as the IRS Intermediate Sanctions regulation.<sup>9</sup>

#### E. Financial Oversight

The St. Paul's School Board exercises careful financial stewardship of St. Paul's School. Through the Budget, Pension and Benefits Committee, the Board oversees an ongoing budgeting and financial planning and reporting process. Through the Investment Committee and the Treasurer, the Board oversees investment policy and performance. Through the Audit Committee, the Board monitors the financial performance, financial reporting, and fiscal health of the School.

---

<sup>9</sup> For example, to qualify for the IRS Intermediate Sanctions "rebuttable presumption safe harbor," the committee's record should include the following if approving a transaction or arrangement with a "disqualified person" (including approval of the compensation of the Rector or other executives): (i) the terms of the transaction approved and the date approved; (ii) the members present during discussion and those who voted for it (the affected individual should be absent except as requested by the committee to be present to answer questions); (iii) comparability data obtained and relied upon and how the data was obtained; (iv) any actions taken with respect to consideration of the transaction by anyone who has a conflict of interest with respect to the transaction; and (v) if a determination is made that a reasonable compensation or price is different from that indicated by the range of comparability data obtained, a record of the basis for the determination. Reg. §53.4958-6(c)(3).



1. Investment oversight

In October 2002, St. Paul's School adopted a new Investment Policy Statement. Under the governance aspects of the Investment Policy Statement:

- a) the Investment Committee as a whole is to oversee the Treasurer in the management of the investment of the endowment (Part II.A);
- b) the Investment Committee is to set and review the investment policy, goals and objectives periodically (Part IV.A.1);
- c) the Investment Committee is to oversee the selection of qualified Investment Managers and Alternative Investments for the endowment's assets by the Treasurer (Part IV.A.2);
- d) the Investment Committee is to monitor overall compliance with the policy and the performance and diversification of the endowment's investments (Part IV.A.3);
- e) the Investment Committee is to set and review the strategic asset allocation of the endowment at least annually (Part IV.A.4);
- f) the Investment Committee is to meet at least three times a year to review the endowment's asset allocation, investments, current investment performance, and related matters (Part III.C);
- g) the Treasurer is from time to time to present reports and other information relating to the management of the endowment to the Investment Committee for its review (Part IV.A.2); and
- h) the Investment Policy Statement is to be reviewed annually (Part III.C).

The governance aspects of the Investment Policy Statement reflect accepted recommended standards as to the role of the Investment Committee. The minutes of the October 2002 Trustees meeting could be read to indicate, however, that the Investment Policy Statement was approved only as a guide. It is not clear that the Board is fully aware of the governance aspects of the Investment Policy Statement or that these aspects of the Investment Policy Statement are being followed.

**Recommendation:** The governance aspects of the October 2002 Investment Policy Statement should be reaffirmed as the policy of the Board, not merely a guide, by a vote of the Board.

The current Bylaws provide at Section 2.6 that in addition to the traditional powers of a Treasurer, the St. Paul's Treasurer "shall have power to make changes in the investments of the funds of the corporation without the vote of the Trustees, except for investments in real estate."

**Recommendation:** This Bylaws provision should be amended to provide that this authority is subject to the oversight of the Board and the Investment Committee, as provided in the Investment Policy Statement and to comport with general nonprofit organizational practice.

## 2. Adherence to endowment restrictions

Under applicable law, all donor restrictions with respect to endowments and other donated funds must be honored. For donor-created endowments, this means that principal may not be expended unless expressly permitted by the donor. The St. Paul's School administration actively monitors the School's endowment funds to ensure that spending from each fund does not reach into principal unless permitted by the donor.

Included in the St. Paul's School endowment are seven Rector's Discretionary Funds, with donative language indicating that the funds are to be used at the Rector's discretion. The School is also the beneficiary of annual income from a separate fund for use at the Rector's discretion. Under a written Discretionary Fund Policy, the Chief Financial Officer and the Controller assist in overseeing expenditures from these funds.

The necessary implication of such funds is that they must be used solely in furtherance of the mission of St. Paul's School<sup>10</sup> -- albeit that the Rector is granted discretion as to the use of the funds within the scope of this purpose, subject to any other purpose restriction imposed by the donor.<sup>11</sup> To view the funds otherwise would raise issues under charities law and the federal income tax code.

**Recommendation:** The Discretionary Fund Policy should include an explicit clarification that the funds may only be used in furtherance of the mission of St. Paul's School. Further, to the extent that the January 2003 statement as to the scope of permitted uses of the Discretionary Funds is still in use, the last four bulleted topics should be made subject to this limitation [these bulleted topics are: (a) support programs

---

<sup>10</sup> Under the legislative charter of St. Paul's School, the corporation's purpose is "to establish and maintain in the City of Concord a school for the education of youth." The mission of St. Paul's School is elaborated, among other places, in the School's formal Mission Statement.

<sup>11</sup> See, *Mills, Trustee of Jessie Ball duPont Religious, Charitable and Educational Trust v. Edward Ball and Episcopal Church in the Diocese of Florida, Inc.*, 380 So.2d 1128 (Dist. Ct. of Appeal of Florida, 1980) (Bishop of the Diocese of Florida testified that clergy discretionary funds are for charitable or pious uses; that such a discretionary fund is a fund of the particular church; and that should a minister or bishop vacate his position, the discretionary fund remains with the institution for his successor in office. The court held that gifts to clergy discretionary funds were gifts to institutions, not to individuals.)

related to the environment; (b) respond to requests for contributions to charities and foundations whose mission is consistent with that of St. Paul's School; (c) support the mission and ministry of the Episcopal Church locally, at the diocesan level, at the national level, and the Anglican communion worldwide; and (d) support other educational institutions, national organizations and associations dedicated to the promotion of education].

**Recommendation:** To enable the Board to fulfill its oversight responsibilities, the Discretionary Fund Policy should provide for periodic reporting to the Board of the uses to which the Discretionary Fund has been devoted.

### 3. The auditor function and the Audit Committee

The financial records of St. Paul's School are examined each year by one of the top auditing firms in the country, PricewaterhouseCoopers LLP. The most recent audits have resulted in favorable unqualified reports.

The Audit Committee oversees this function in conjunction with the St. Paul's School staff. The Audit Committee selects the auditor, reviews auditor fees, approves all work arrangements with the School by the auditor firm, reviews all reports from the auditor, meets with the auditor (including meeting without the presence of staff) to review the auditor's findings, and reports to the Executive Committee and the full Board.

**Recommendation:** Given the importance of the IRS Form 990 as a widely available public report, the Form 990 should be presented to and approved by the Audit Committee before it is filed. The filed Form 990 should be distributed to the full Board.

The Attorney General's governance consultant recommends that: (a) the auditor should be prohibited from providing non-auditing services contemporaneously with the audit; (b) preferably the School should periodically rotate auditing firms, and at a minimum the lead audit partner and lead review partner should be rotated off the engagement after five years; (c) an auditor should not be hired if any of the School's senior management was employed by the auditing firm and participated in any capacity in the audit of the School within one year before the initiation of the audit; and (d) the Rector and the CFO should certify to the Audit Committee that the financial statements are presented fairly in all material aspects and that there are no known significant control deficiencies or fraud which have not been addressed and resolved.

These recommendations are borrowed from the federal Sarbanes-Oxley legislation that was enacted in 2002 for publicly traded business corporations after the corporate and accounting scandals of Enron, Arthur Andersen, and others. They are not legal requirements for nonprofit organizations such as St. Paul's School, and there is nothing in St. Paul's School financial practices, recent or historical, that suggests that extra, non-traditional safeguards against misleading accounting and financial reports are

needed. Nonetheless, many Sarbanes-Oxley principles are viewed seriously by nonprofit organizations and governance commentators as reflective of recommended practices, especially in this era of close scrutiny of nonprofit organizations as well as publicly traded businesses.

**Recommendation:** The question of whether to adopt these Sarbanes-Oxley restraints is one of discretionary judgment for St. Paul's School. A reasonable approach – an approach that I recommend -- is suggested by Independent Sector, BoardSource, and the National Association of College and University Business Officers (NACUBO), three leading organizations in the field of nonprofit accountability:

- a) to avoid inherent conflicts between the carrying out of management functions and auditing the financial results of those functions, prohibit the use of the auditing firm for most non-audit services, but permit tax preparation and reporting and related services by the auditing firm, with the latter services approved in advance by the Audit Committee;
- b) require that the auditing firm's lead and reviewing partners be rotated off the engagement every 5 to 7 years;
- c) if Senior Management of St. Paul's School was in the employment of the auditing firm within the past year (not a present circumstance at St. Paul's School), the one-year waiting period articulated in Sarbanes-Oxley may be waived by the full Board after documenting the benefits and risks of engaging the audit firm; and
- d) while nothing in the practices of St. Paul's suggests that extra financial certifications are necessary like they are deemed to be for publicly traded companies as an investor-protection, and while requiring the Rector to sign such certifications undermines the management efficiencies gained by delegation of specialized financial responsibility, requiring such certifications by the CFO strikes the right balance.

#### 4. Whistle-blower and document destruction standards

The Sarbanes-Oxley legislation contains two requirements that apply to nonprofit organizations as well as publicly-traded companies:

- a) in a "whistle-blower" protection provision, the legislation makes it a crime to take, with the intent to retaliate, any action that is harmful to a person, including interference with employment or livelihood, for providing to a law enforcement officer any truthful information relating to the possible commission of a federal offense (such as a violation of federal tax code requirements); and

- b) because of document destruction issues in the Enron and Arthur Andersen and other matters, the legislation makes it a crime to knowingly destroy a document with the intent to obstruct or influence the investigation or proper administration of any federal matter.

**Recommendation:** To protect against violation of these provisions, Independent Sector, BoardSource, and NACUBO recommend, and I join in recommending: (i) develop, adopt and disclose a formal process to receive and deal with complaints regarding accounting, internal controls, governmental certifications, and auditing matters, with an identified Board member to receive complaints if desired by the complainant, and with a clear statement that retaliation will not be permitted; and (ii) develop a written, mandatory document management policy to guide the Board and staff in the retention and disposing of documents.

F. The Board's operational oversight of St. Paul's School

The Board is actively and appropriately engaged in oversight of the operations of St. Paul's School. Comprehensive reports are received from and through the Rector and are discussed at Trustee meetings. As well, the President, the Executive Committee, and the various ongoing committees are actively engaged in operational oversight between Trustees meetings.

The Rector's performance is evaluated annually by the Executive Committee, with a comprehensive review of compensation. Recently, aspects of this function, as well as compensation review of the senior staff who report directly to the Rector, were assigned to a Compensation Committee.

For a number of years, the St. Paul's School's Board has followed an express policy, as stated, for example, in the Strategic Plan, that the students of the School are best served by recruiting, training, and retaining "the best staff by offering compensation and benefits, including retirement programs, in the top rank of appropriate benchmarks." Such a policy is within the sound discretion of an independent Board of a school of the caliber of St. Paul's School.

In order to ensure that the compensation paid by the School to the Rector reflected appropriate benchmarks, the Board engaged an experienced compensation consultant who was independent of management. The Rector was not involved in recruiting or hiring the consultant, and was not involved in the approval of the compensation. The compensation consultant repeatedly assured the Executive Committee and the Board that the Rector compensation paid by St. Paul's School was prudent and not out of line when compared with compensation paid by other national schools.

**Recommendation:** The Rector compensation process has been managed closely by the Executive Committee each year, pursuant to authority delegated by the Board. The Board as a whole has been less involved and, perhaps to some extent, less than fully knowledgeable about the matter. Because the compensation paid to the head of an organization is such an important component of the Board's overall responsibilities, in the future the committee (formerly the Executive Committee, now the Compensation Committee) should report back to the full Board in detail, including the contents of any contract, and the compensation and the contract should be ratified by the full Board.

G. Activities of the Committee on Trustees

The Nominating and Evaluating Committee (recommended revised name, "Committee on Trustees") is actively leading the Board's recruitment of Trustees, orientation of new Trustees, training, evaluation, succession planning, and promotion of good governance practices. As part of this effort, the individual Trustees annually complete a Board evaluation form.

St. Paul's School has a conflict of interest policy that applies to Trustees in all facets of their Trustee role, including service on committees. Disclosures are signed annually, and these disclosures indicate that for most of the Trustees, there are no related party matters between St. Paul's School and the Trustees or their families or businesses (the rare exceptions are of a de minimis nature.).

**Recommendation:** The conflict of interest policy should be revised to include all components of the IRS Intermediate Sanctions disqualified person definition.

**Recommendation:** Materials provided to Trustees for orientation and training purposes, and on an ongoing basis, should include the Conflict of Interest Policy and other pertinent policies, the most recent audit-related documents received from the auditor, and the most recent Form 990.

**Recommendation:** The Board self-evaluation form should be expanded to permit respondents to evaluate the performance of committees and of individual trustees.

**Recommendation:** The Committee on Trustees should be responsible for conflict of interest policy training and implementation of the conflict of interest policy, including the collection and review of conflict of interest disclosure forms.

The Attorney General's governance consultant recommends the adoption of an ethics code for Board members, administration, faculty, and other employees. This is borrowed from the Sarbanes-Oxley provisions applicable to publicly-traded companies. It is clear, however, that the highest standards of ethical behavior are expected and practiced at St. Paul's School. These standards and expectations are manifest in the School's affiliation with the Episcopal Church and are set forth, among other places, in

the St. Paul's School mission statement, the conflict of interest policy, and the All Employee Handbook. The formal complaint process recommended in Part D.4, above, would provide an additional manifestation. It would be reasonable for the Board to conclude that additional articulation is not necessary, although, given the high standards to which St. Paul's School is devoted, a comprehensive ethics code or statement would be commendable.

### SUMMARY OF RECOMMENDATIONS

While fundamentally the governance of St. Paul's School is exemplary, there are refinements to the governance structure and processes that commend themselves to the Board's consideration:

1. revise the St. Paul's School bylaws provisions relating to the minimum vote threshold required to take the following significant corporate actions: amendment of the Bylaws, amendment of the charter, change of the corporation's name, change of location, merger, sale of the corporation's assets, and dissolution (page 3);
2. correct the cross-reference in Section 6.2 of the Bylaws, from Section 1.6 to Section 1.7 (page 3);
3. engage in a focused Board discussion of whether the Trustee term provisions as presently stated the Bylaws should remain as written or whether they should be adjusted (page 5);
4. in conjunction with the Trustee term limit discussion, consider whether to establish a term limit for service as an Officer of the corporation (page 6);
5. focus on succession planning for the three top offices, and consider adding an office of Vice-President elected by and from the Trustees (page 6);
6. submit Officer nominations to the Trustees in advance of the Trustees meeting, and during the Officer election discussion and vote, the candidates should absent themselves from the meeting (page 6);
7. amend the Bylaws to clarify that full Board action, not action by the Executive Committee, is required for significant corporate actions such as election and removal of Officers, amendment of the Bylaws, amendment of the charter, change of the corporation's name, change of location, merger, sale of the corporation's assets, and dissolution (page 7);
8. amend the Bylaws to provide: (a) that the Board have establishment and approval authority with respect to the formation, continuation and cessation of



committees; and (b) that the following are standing committees of the Board (and with the responsibilities of each of these committees set forth in the Bylaws): (i) an Investment Committee; (ii) a separate Budget, Pension and Benefits Committee (renamed "Finance Committee," or something to this effect, to reflect the committee's role); (iii) a Nominating/Governance Committee (renamed "Committee on Trustees," or something to this effect, to reflect the committee's mission); and (iv) an Audit Committee (page 8);

9. amend the Bylaws to require Board approval of committee appointments, with Executive Committee approval required with respect to committee appointments that need to be made between Board meetings (page 8);
10. the Audit Committee, Governance Committee, and Compensation Committee should be comprised solely of members who are independent -- that is, the Committee should be comprised solely of members who are not employed by the organization, who do not have a business or financial arrangement with the organization or the organization's executives, who do not receive payment from the organization for service on the committee, and whose family members are not employed by, nor have a business or financial arrangement with, the organization.. The Rector should not serve as a member of these committees, and the practice of staff not serving as voting members should continue (although the Rector and staff should continue to attend committee meetings and provide staff support, subject to recusal when the committee is considering matters affecting the individual's personal interests) (page 9);
11. the bylaw amendment institutionalizing the Audit Committee should specify, as is the St. Paul's School practice, that the Treasurer shall not serve as member of the Audit Committee (page 10);
12. the Nominating and Evaluating Committee should include not-for-profit education financial expertise in the desired criteria for the recruitment of new Trustees, with an aspirational goal of including at least one Trustee with this expertise on the Audit Committee (page 10);
13. all committees, including the Executive Committee, should maintain a written record of their work and report in writing to the full Board in advance of each Board meeting (page 11);
14. the governance aspects of the October 2002 Investment Policy Statement should be reaffirmed as the policy of the Board, not merely a guide, by a vote of the Board (page 12);
15. Section 2.6 of the Bylaws should be amended to provide that the authority of the Treasurer with respect to investments is subject to the oversight of the

Board and the Investment Committee, as provided in the Investment Policy Statement (page 13);

16. the Discretionary Fund Policy should include an explicit clarification that the funds may only be used in furtherance of the mission of St. Paul's School. Also, to the extent that the January 2003 statement as to the scope of permitted uses of the Discretionary Funds is still in use, the last four bulleted topics should be made subject to this limitation (page 13);
17. to enable the Board to fulfill its oversight responsibilities, the Discretionary Fund Policy should provide for periodic reporting to the Board of the purposes to which the Discretionary Fund has been devoted (page 14);
18. the Form 990 should be presented to and approved by the Audit Committee before it is filed. The filed Form 990 should be distributed to the full Board (page 14);
19. the following audit oversight practices, borrowed from the federal Sarbanes-Oxley legislation for publicly traded companies, should be adopted: (a) prohibit the use of the auditing firm for most non-audit services, but permit tax preparation and reporting and similar services by the auditing firm, with the latter services approved in advance by the Audit Committee; (b) require that the auditing firm's lead and reviewing partners be rotated off the engagement every 5 to 7 years; (c) if Senior Management of St. Paul's School was in the employment of the auditing firm within the past year, the one-year waiting period articulated in Sarbanes-Oxley may be waived by the full Board after documenting the benefits and risks of engaging the audit firm; and (d) the CFO should certify to the Audit Committee that the financial statements are presented fairly in all material aspects and that there are no known significant control deficiencies or fraud which have not been addressed and resolved (page 15);
20. to protect against violation of whistle-blower protection and document destruction prohibitions in the Sarbanes-Oxley legislation that are applicable to nonprofits, the School should: (i) develop, adopt and disclose a formal process to receive and deal with complaints regarding accounting, internal controls, governmental certifications, and auditing matters, with an identified Board member to receive complaints if desired by the complainant, and with a clear statement that retaliation will not be permitted; and (ii) develop a written, mandatory document management policy to guide the Board and staff in the retention and disposing of documents. (page 16);

21. the committee dealing with Rector compensation should report back to the full Board in detail, including the contents of any contract, and the compensation and the contract should be ratified by the full Board. (page 17)
22. the conflict of interest policy should be revised to include all components of the IRS Intermediate Sanctions disqualified person definition (page 17).
23. materials provided to Trustees for orientation and training purposes, and on an ongoing basis, should include the Conflict of Interest Policy and other pertinent policies, the most recent audit-related documents received from the auditor, and the most recent Form 990 (page 17);
24. the Board self-evaluation form should be expanded to permit respondents to evaluate the performance of committees and of individual trustees (page 17);
25. the Committee on Trustees should be responsible for conflict of interest policy training and implementation of the conflict of interest policy, including the collection and review of conflict of interest disclosure forms (page 17).

Respectfully submitted,

Richard C. Allen

## ATTACHMENT A

### ST. PAUL'S SCHOOL MATERIALS REVIEWED

St. Paul's School materials reviewed include the following:

1. Werner Report (Rector search report 1996)
2. Pappas Diagnostic Report (April 1998)
3. "The St. Paul's School Program Review: Reactions and Recommendations" (Wickenden Associates) (November 1999)
4. State Street Financial Projections Report (January 2000)
5. St. Paul's School Strategic Plan (2000)
6. "St. Paul's School Long Range Master Plan – Amendment #1 (January 31, 2001)
7. "State of the School" Rector's Report (February 7, 2003)
8. "A Message from the Trustees of St. Paul's School" (June 2003) (presentation of the State of the School Report to the SPS community)
9. St. Paul's School legislative charter and articles of organization
10. St. Paul's School Bylaws
11. Sample Board of Trustees meeting agendas
12. Sample Board of Trustees background papers binder
13. Board of Trustees minutes for 1997 to present
14. Audited financial statements, auditor's results letters, and auditor's management letters for 1999, 2000, 2001, 2002, 2003
15. IRS Form 990 filings for 1999 to present
16. Conflict of Interest Policy
17. Conflict of Interest disclosure forms signed by Trustees for 1999-2003
18. Trustee Governance Evaluation Forms signed by Trustees in 2003 and in 2004
19. All written communications from AG's Office (June 2003 to present)
20. All documents submitted by St. Paul's School to Attorney General's Office (May 2003 to present)
21. Investment Policy
22. Discretionary Fund Policy
23. Contract Signing & Purchasing Policy
24. Expense Reimbursement Policy
25. Travel Advance Policy
26. All Employee Handbook and Staff Supplement and Faculty Supplement
27. Sampling of communications received by St. Paul's School from persons critical of School's governance
28. Draft report of Professor Jay O. Light (investment review consultant to St. Paul's School)
29. Recommendations of David E. Ormstedt, Esq. (governance consultant to Attorney General's Office)

# ATTACHMENT B

## ST. PAUL'S SCHOOL BOARD OF TRUSTEES <sup>12</sup>

### CURRENT YEARS OF SERVICE

Beginning Year	Years of Service	Total Trustees
2002 - 2003	1 - 2	8
2000 - 2001	3 - 4 <sup>13</sup>	7
1998 - 1999	5 - 6	3
1996 - 1997	7 - 8	1
1994 - 1995	9 - 10 <sup>14</sup>	2
1984 - 1993	17	1
1978 - 1983	26	1

Median length of current service = 4 years  
Average years of current service = 5.5 years

8035.0/315432.4

---

<sup>12</sup> Not including Rector.

<sup>13</sup> One Trustee served previously for 4 years, with 23 year hiatus before current service.

<sup>14</sup> One Trustee served previously for 8 years, with 13 year hiatus before current service.